

## Message Text

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ACTION ARA-14

INFO OCT-01 ISO-00 SP-02 USIA-06 AID-05 EB-08 NSC-05  
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-----129423 311423Z /53

R 302145Z AUG 77  
FM AMEMBASSY PANAMA  
TO SECSTATE WASHDC 3453

C O N F I D E N T I A L SECTION 1 OF 3 PANAMA 6253

E.O. 11652: GDS  
TAGS: ECON, EFIN, PN  
SUBJECT: GOP FINANCIAL CONDITION

REF: A) PANAMA A-02; B) PANAMA 0975

SUMMARY: THE FINANCIAL CONDITION OF THE GOP IS WEAK.  
NATIONAL DEBT HAS GROWN MARKEDLY IN RECENT YEARS AS INCREASED  
GOVERNMENT SPENDING HAS ATTEMPTED TO KEEP THE ECONOMY MOVING  
THROUGH THE RECESSION. NEW REVENUE-PRODUCING EFFORTS AND  
EXPENDITURE CONTROLS WITHIN GOVERNMENT HAVE NOT CLOSED THE  
GAP BETWEEN INCOME AND OUTGO. PANAMA SUFFERS MOST FROM THE  
HIGH PRICE OF OIL IMPORTS AND THE LOW PRICE OF SUGAR EXPORTS.  
PANAMA LOOKS HOPEFULLY TOWARD THE DIRECT ECONOMIC BENEFITS  
ACCOMPANYING A NEW TREATY WHICH WOULD APPARENTLY SUFFICE TO  
KEEP THE GOVERNMENT IN THE BLACK UNTIL ABOUT 1980, BUT THE  
TREATY WILL BY NO MEANS SOLVE PANAMA'S ECONOMIC PROBLEMS;  
CERTAINLY NOT IN THE LONG RUN. PANAMA MUST RELY ON THE CON-  
TINUATION OF FAVORABLE LOAN POLICIES BY THE IFI'S TOWARD THE  
LDC'S IN THE FORESEEABLE FUTURE AND ON COMMERCIAL BANK  
BORROWINGS. THE CANAL AND THE CANAL ZONE WILL CONTINUE  
TO BE OF ECONOMIC IMPORTANCE AND CONCERN WHETHER OR NOT  
THERE IS A TREATY. END SUMMARY.

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1. IT IS CLEAR THAT PANAMA HAS NOT RECOVERED FROM  
THE EFFECTS OF THE RECESSION AND THAT THE ANTI-  
CIPATED ECONOMIC UPTURN HAS NOT ARRIVED AS PREDICTED.  
INDEED, WHETHER OR NOT PANAMA WILL EVER AGAIN ATTAIN ITS  
PRE-RECESSION ECONOMIC GROWTH RATE IS PROBLEMATICAL.

2. WITH THE RECESSION OF 1975-6 THE GOP STEPPED IN TO COMPENSATE--AT LEAST PARTIALLY--FOR THE DOWNTURN IN PRIVATE INVESTMENT, BUT HAS BEEN HAVING DIFFICULTY MAINTAINING PUBLIC EXPENDITURES AT THE HIGH RATE OF THE PAST TWO YEARS. THE GOVERNMENT ANTICIPATED A SIGNIFICANT ECONOMIC RECOVERY TO BEGIN IN LATE 1976 OR EARLY 1977 (SEE REF A); THE RECOVERY HAS NOT MATERIALIZED AND THE GOVERNMENT HAS BEEN FACED WITH GROWING NATIONAL DEBT AND SHORTFALLS IN OPERATING REVENUES.

3. PANAMA'S NATIONAL DEBT HAS INCREASED MARKEDLY FROM \$791 MILLION AS OF DECEMBER 31, 1974, TO \$1,425 MILLION AS OF DECEMBER 31, 1976 (AND ESTIMATED \$1,630 MILLION AS OF DECEMBER 31, 1977). DEBT-SERVICE REQUIREMENTS INCREASED FROM \$138 MILLION IN 1975 TO \$253 MILLION IN 1977. AT THE SAME TIME THERE HAS BEEN DEVELOPING AN INCREASING CONCERN ON THE PART OF THE IFI'S OVER THE ULTIMATE ABILITY OF THE LDC'S TO SUPPORT THEIR MOUNTING FOREIGN DEBTS, OR EVEN THEIR ABILITY TO MEET CURRENT DEBT-SERVICE REQUIREMENTS.

4. THE GOP PRIDES ITSELF ON ITS RECORD OF REPAYMENT OF INTERNATIONAL OBLIGATIONS, WHICH IT RECOGNIZES AS A VALUABLE ASSET SUPPORTING ITS CREDITWORTHINESS FOR FUTURE LOANS. BUT IN RECENT MONTHS, THE GOP APPEARS TO HAVE BECOME INCREASINGLY CONCERNED OVER THEIR RAPIDLY-MOUNTING DEBT-SERVICE REQUIREMENT; FURTHERMORE, MAJOR GOVERNMENT

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BORROWINGS HAVE BEEN SOMEWHAT SLOWER FORTHCOMING THAN IN PREVIOUS YEARS. BANKS WHICH HAVE PARTICIPATED IN LARGE SYNDICATED PRIVATE LOANS TO THE GOP IN RECENT YEARS ARE CAUTIOUS ABOUT INCREASING THEIR GOP EXPOSURE, AND THE MAJOR, \$100-MILLION LOAN THIS YEAR APPARENTLY TOOK LONGER TO BE "PLACED" THAN LAST YEAR'S MAJOR SYNDICATED LOAN (\$80 MILLION) AND INVOLVED THE PARTICIPATION OF SEVERAL NEW BANKS. FURTHERMORE, SHORT TERM GOP BORROWINGS (3-4 YEARS) WHICH UNDERWENT A RAPID INCREASE AROUND 1973-4 ARE NOW FALLING DUE, CAUSING ADDITIONAL PRESSURE ON THE DEBT-SERVICE BURDEN AND THE GOP'S FINANCIAL REQUIREMENTS.

5. THE POSITION OF THE GOVERNMENT THROUGH THESE RECESSION YEARS HAS APPARENTLY BEEN AN ATTEMPT TO BALANCE THE EXPENDITURE REQUIREMENTS NECESSARY TO MAINTAIN ITS IMAGE OF CONCERN FOR NATIONAL DEVELOPMENT AND WELFARE OF THE POPULACE ON THE ONE HAND, AND ITS CURRENT REVENUES PLUS TOLERABLE INCREASES IN NATIONAL DEBT ON THE OTHER. THE RECESSION HIT BOTH SIDES OF THIS BALANCE: IT REQUIRED AN EXPANSION OF PUBLIC EXPENDITURES--TO ABSORB UNEMPLOYMENT, HELP MAINTAIN REASONABLE LEVEL OF BUSINESS ACTIVITY, ETC.--AND ALSO CUT INTO CURRENT GOVERNMENT

REVENUES BY CONSTRICTING THE TAX BASE.

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FM AMEMBASSY PANAMA  
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6. UNDER THESE CIRCUMSTANCES, IT IS EASY TO UNDER-  
STAND THE EAGERNESS WITH WHICH PANAMA HAS LOOKED  
TOWARD THE POSSIBILITY OF FAVORABLE ECONOMIC PROVISIONS  
AS PART OF A NEW CANAL TREATY. PANAMA NATURALLY SEES A  
SIGNIFICANT AND STEADY INCOME FROM ABROAD AS HELPING TO  
SOLVE HER PROBLEMS CONCERNING TRADE DEFICIT, MOUNTING FOREIGN  
DEBT AND DEBT SERVICE, DESIRABLE NATIONAL DEVELOPMENT  
AND SOCIAL WELFARE PROJECTS, AND ANY POSSIBLE  
IMBALANCE BETWEEN OPERATING EXPENSES AND CURRENT REVENUE.  
(A QUANTUM INCREASE OF \$50 MILLION IN ANNUAL REVENUES  
WOULD ENABLE PANAMA TO MEET PROJECTED CURRENT EXPENDITURES  
AND DEBT-SERVICE REQUIREMENTS UNTIL ABOUT 1980--ALTHOUGH  
THE TOTAL NATIONAL DEBT WOULD, OF COURSE, CONTINUE TO GROW  
THROUGH NEW CAPITAL BORROWINGS.

7. AGAINST THE BACKGROUND OF INCREASING PRESSURE AND  
CONSTRAINTS FROM DIFFERENT DIRECTIONS, THE GOP HAS UNDER-  
TAKEN VARIOUS MEASURES. THESE MEASURES INCLUDED EFFORTS  
TO STIMULATE PRIVATE INVESTMENT AND BUSINESS ACTIVITY  
THROUGH CERTAIN LABOR CODE MODIFICATIONS FAVORABLE  
TO MANAGEMENT AND AN EXTENSION OF FAVORABLE TAX TREAT-  
MENT FOR NEW CONSTRUCTION (REF B). THEY ALSO INCLUDED  
MEASURES TO GENERATE MORE REVENUE--A 5 PERCENT TAX (ITBM  
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"TRANSFER TAX") ON MERCHANDISE, AND GENERAL INCREASES IN PUBLIC UTILITY RATES EARLY THIS YEAR, AND MEASURES TO LIMIT GOVERNMENT EXPENDITURES--THROUGH "AUSTERITY" IN GOVERNMENT OPERATIONS AND PROGRAM EXECUTION AND STRETCHING-OUT OR POSTPONING INITIATION OF PROGRAMS THEMSELVES. AN EXAMINATION OF THESE MEASURES MAY GIVE SOME INDICATION OR ESTIMATE OF THE SEVERITY OF THE FINANCIAL SQUEEZE FELT BY THE GOP. (HOWEVER, THE VERY MEASURES BEING TAKEN TO RELIEVE THAT SQUEEZE ARE VIEWED AS AN INDICATION OF THE SQUEEZE ITSELF.)

8. MEASURES OR TECHNIQUES TAKEN TO LIMIT THE GOVERNMENT'S EXPENDITURES HAVE INCLUDED EFFORTS TO RESTRICT OFFICIAL USE OF VEHICLES, TELEPHONES, AIRCONDITIONERS, ETC.--ESSENTIALLY A TURN-OFF-THE-LIGHTS CAMPAIGN. ALSO IN JANUARY 1977, THE GOVERNMENT ANNOUNCED A SALARY CUT FOR OFFICIALS EARNING OVER \$500 PER MONTH TO BE APPLIED ON A SLIDING SCALE REACHING TO A 20 PER CENT REDUCTION FOR THE TOP SALARIES. EXEMPTIONS WERE GRANTED SPECIAL CATEGORIES SUCH AS TEACHERS, DOCTORS, AND TECHNICIANS. SWAMPED BY PETITIONS FOR SPECIAL CONSIDERATION AND COMPLAINTS OF INEQUITY. THE GOVERNMENT SCRAPPED THE SALARY-CUT PROJECT AFTER ONLY TWO MONTHS, ANNOUNCING, HOWEVER, THAT IT HAD SERVED ITS PURPOSE AND THE POINT---THE NEED FOR AUSTERITY--HAD BEEN MADE.

9. THE GOVERNMENT HAS A REPUTATION FOR LATE-PAYING OF BILLS FOR COMMERCIAL SERVICES, THREE OR FOUR MONTHS DELAY APPARENTLY BEING COMMON. SOMETIMES THE GOVERNMENT ISSUES LOW-INTEREST-BEARING IOU'S WHICH MAY--OR MAY NOT--BE TRADED IN THE MARKET (AT A DISCOUNT). HOWEVER, THIS PRACTICE OF LATE PAYMENT IS NOTHING NEW ALTHOUGH SOME OBSERVERS BELIEVE IT MAY BE SOMEWHAT WORSE OF LATE. INDEED  
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SOME SUPPLIERS ARE RELUCTANT TO DEAL WITH THE GOVERNMENT FOR THIS REASON, BUT OTHERS LOOK TO THE GOVERNMENT AS A RELIABLE--AND THE PRINCIPAL--CONSUMER IN IMPORTANT INDUSTRIES SUCH AS CONSTRUCTION. THE GOVERNMENT HAS ALSO BEEN BORROWING SIGNIFICANT AMOUNTS--UP TO \$20 MILLION PER YEAR--FROM ITS SOCIAL SECURITY ADMINISTRATION THROUGH THE SIMPLE EXPEDIENT OF PAYING ITS OWN CONTRIBUTION AS EMPLOYER BY MEANS OF SPECIAL BONDS. HOWEVER, THIS PRACTICE IS NOT NEW, ALTHOUGH THE TOTAL OUTSTANDING HAS BEEN INCREASING AND NOW IS ABOUT \$150 MILLION.

10. HOWEVER, THE MOST SIGNIFICANT FLEXIBILITY IN GOP FINANCIAL MANAGEMENT RESTS IN THE ABILITY TO STRETCH-OUT

OR POSTPONE CAPITAL INVESTMENT PROJECTS. CURRENT REVENUES ESSENTIALLY COVER CURRENT OPERATING EXPENDITURES, BOTH IN THE CENTRAL GOVERNMENT AND IN THE AUTONOMOUS AGENCIES (UTILITIES, ETC. WHICH, HOWEVER, ARE UNDERWRITTEN BY THE GOVERNMENT, OF COURSE). CAPITAL EXPENDITURES ARE GENERALLY FINANCED BY NEW BORROWINGS, AND THEREFORE ARE EASILY AND DIRECTLY ADJUSTED ACCORDING TO THE AVAILABILITY OF NEW LOANS AND THE WILLINGNESS OF THE GOVERNMENT TO SINK FURTHER INTO DEBT. THE DEBT-SERVICE REQUIREMENT--AT LEAST THE INTEREST PORTION--IS CARRIED ON CURRENT ACCOUNT AND ACCORDINGLY COMPETES WITH CURRENT EXPENSES FOR OPERATING FUNDS. THERE IS GREATER DIFFICULTY IN ENSURING THE ESSENTIAL ADEQUACY OF CURRENT REVENUES TO MEET CURRENT OPERATING EXPENSES, FOR HERE THERE IS LESS FLEXIBILITY. WHEN THERE IS NO OTHER RECOURSE AVAILABLE, THE GOVERNMENT MAY MAINTAIN THIS BALANCE THROUGH THE--PERHAPS QUESTIONABLE--PRACTICE OF "TRANSFERS," AN ACCOUNTING TECHNIQUE WHICH ENABLES FUNDS FROM CAPITAL ACCOUNTS TO BE RECORDED AS REVENUES ON THE CURRENT ACCOUNT. IT IS EXTREMELY DIFFICULT--FOR ONE OTHER AN ACCOUNTANT REVIEWING THE BOOKS THEMSELVES--TO DETERMINE THE EXTENT TO WHICH SUCH DIVERSIONS OF CAPITAL RESOURCES TO CURRENT REVENUES HAVE BEEN MADE OR ARE BEING MADE.

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FM AMEMBASSY PANAMA

TO SECSTATE WASHDC 3455

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DATA INDICATES THAT THERE WAS A 1976 CURRENT ACCOUNT SHORT-FALL OF ABOUT \$45 MILLION, LARGELY COVERED BY SUCH TRANSFERS, AND THAT IN 1977 THE SHORTFALL AND TRANSFERS WILL BE ABOUT \$20 MILLION--AN IMPROVEMENT OVER 1976 SHOWING THE EFFECT OF THE NEW TAX, ETC. WE DO NOT KNOW THE EXTENT OF THE POSSIBILITIES FOR MANIPULATING ACCOUNTS, ESPECIALLY IN THE AUTONOMOUS AGENCIES. NEVERTHELESS, IT IS CLEAR THAT DIVERSION OF CAPITAL FUNDS TO CURRENT ACCOUNT IS AN ULTIMATE ESCAPE FROM FINANCIAL INSOLVENCY WHEN OTHER METHODS FAIL OR ARE INADEQUATE. IT SEEMS MOST UNLIKELY THAT THE GOVERNMENT WOULD DEFAULT ON MAJOR OBLIGATIONS WHEN IT IS POSSIBLE TO DIVERT PROGRAM FUNDS IN THIS WAY. THEREFORE, THE CONCEPT OF A FINANCIAL CRUNCH OCCURRING IN A PARTICULAR MONTH, INVOLVING FOR INSTANCE DEFAULT ON INTERNATIONAL COMMITMENTS SUCH AS IFI LOANS, IS MOST UNLIKELY AND WOULD REPRESENT A GROSS FAILURE TO EXERCISE THE FINANCIAL PLANNING TOOLS WHICH EXIST.

11. THE GREATER PROBLEM--AND THE REAL PROBLEM--IS THE LONG-RUN BASIC ABILITY OF A NATION TO REPAY DEBT AND PRINCIPAL AND THIS ABILITY IS ROOTED IN THE NATION'S PRODUCTIVE CAPABILITY. NOT ALL OF THE LOANS WHICH PANAMA IS RECEIVING WILL PROVIDE FUNDS TO

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IMPROVE ITS EXPORT EARNINGS OR EVEN INCREASE ITS CAPABILITY TO PRODUCE FOR DOMESTIC CONSUMPTION. THESE ARE PRIMARILY THE AID-TYPE LOANS--HOUSING, HEALTH, EDUCATION, ETC.--WHICH, ALBEIT ESSENTIAL, ARE NOT IMMEDIATELY PRODUCTIVE. THE GOVERNMENT IS ALSO IN AN EMBARRASSING POSITION IN SUGAR, WITH TWO MORE EXPENSIVE SUGAR MILLS RECENTLY COMPLETED WHICH HAVE GREATLY ADDED TO THE DEBT AND DEBT-SERVICE REQUIREMENT BUT WHICH WITH THE FALL OF SUGAR PRICES CAN ONLY OPERATE AT A DEFICIT.

12. PANAMA'S WEAKNESS LIES IN ITS DELICATE ECONOMY WHICH TO A CONSIDERABLE EXTENT IS TIED TO THE VICISSITUDES OF THE INTERNATIONAL ECONOMY AND POLICIES OR CONDITIONS OUTSIDE OF ITS CONTROL. PANAMANIAN ARE INCLINED TO VIEW THESE EXTERNAL INFLUENCES AS EVEN GREATER THAN THEY ACTUALLY ARE, FOR INSTANCE OFTEN BLAMING INTERNAL ECONOMIC PROBLEMS ON "IMPORTED INFLATION". ACCORDINGLY, THERE IS A CERTAIN SENSE OF FRUSTRATION WHICH MAY RESULT IN A FATALISTIC OR WHAT-THE-HECK ATTITUDE AND IN THE FAILURE OF PANAMA EVEN TO TAKE ALL MEASURES WHICH ARE IN ITS POWER TO IMPROVE ITS POSITION. (FOR INSTANCE, IT HAS BEEN RELUCTANT TO DEVELOP POSSIBILITIES FOR TOURISM, POSSIBLY FOR REASONS OF NATIONALISM, I.A., AND SUFFERS FROM ITS INTERNAL LABOR STRUCTURE AND WAGE RATES WHEN

COMPETING WITH OTHER LA COUNTRIES IN BOTH FOREIGN AND DOMESTIC MARKETS.)

13. SUFFICE IT TO SAY, PANAMA COULD LIVE AND PROSPER AS A RESPECTABLE MEMBER OF THE INTERNATIONAL ECONOMIC COMMUNITY IF THERE IS AN INTERNATIONAL SUGAR AGREEMENT WHICH ASSURES A PROFITABLE INTERNATIONAL SUGAR PRICE AND MARKETING OPPORTUNITY, A REASONABLE STABILITY IN PRICE OF IMPORTED OIL, CONTINUING AVAILABILITY OF MARKETS FOR BANANAS AND HER SMALL EXPORTS OF

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SHRIMP, COFFEE AND BEEF, AND LONG-TERM TOLERANCE ON THE PART OF THE IFI'S AND THE REST OF THE WORLD'S MAJOR INTERNATIONAL CREDITORS TOWARD ALLOWING THE FOREIGN DEBT OF THE LDC'S TO CONTINUE AND TO GROW IN YEARS TO COME.

14. THERE IS LITTLE DOUBT THAT A SUDDEN CHANGE OF ATTITUDE BY THE IFI'S COULD BRING ABOUT AN ECONOMIC COLLAPSE OR NEAR-COLLAPSE IN PANAMA, I.E., BY CALLING FOR REPAYMENT OF OLD LOANS WHILE RESTRICTING NEW LENDING IN AN ATTEMPT TO REDUCE LDC DEBTS. LOSS OF THE CONFIDENCE OF PRIVATE BANKS IN THE LDC'S AND EXCESSIVE CONTRACTION OF LOANS TO THE GOVERNMENT WOULD HAVE THE SAME EFFECT. AND BANK CONFIDENCE IN THE LDC'S GOES FAR BEYOND PANAMA'S NATIONAL BORDERS. IT IS LARGELY OUT OF THE GOP'S HANDS. ACCORDINGLY, IT WOULD APPEAR THAT ANY CHANGE IN IFI POLICY SHOULD BE TAKEN MOST ADVISEDLY AND MUST BE APPLIED GRADUALLY OVER TIME.

15. THE INTIMATE INFLUENCE OF THE CANAL AND THE CANAL ZONE IN PANAMA'S ECONOMY WILL CONTINUE AND WILL CHANGE IF A TREATY IS RATIFIED AND ALSO IF NO TREATY IS RATIFIED; THE SPECIFIC PROBLEMS WILL BE DIFFERENT BUT WILL WARRANT THE EMBASSY'S CONTINUED CONCERN AND ATTENTION IN EITHER CASE.

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## Message Attributes

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